in the Supreme Court of the United States

OCTOBER TERM, 1975

CASE NO. 75-969

S. D. COHN & COMPANY and SIDNEY D. COHN,
Petitioners,

vs.

SHIRLEY WOOLF and ROBERT MILBERG, and FIBERGLASS RESOURCES CORPORATION
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS IN AND FOR THE FIFTH CIRCUIT

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A.

OPINIONS BELOW

The petitioners, S. D. COHN & COMPANY and SIDNEY D. COHN, seek a writ of certiorari to review the judgments and decision of the United States Court of Appeals for the Fifth Circuit in the case of SHIRLEY WOOLF and ROBERT MILBERG, Plaintiffs, Appellants, vs. S. D. COHN & COMPANY & SIDNEY D. COHN, Defendants, Appellees [case nos. 73-4044; and 74-2449] 5 Cir. 1975, 515 F.2d 591; rehearing denied, 521 F.2d 225. The decision of the Fifth Circuit vacated a judgment and order of the United States District Court, In and For The Southern District of Florida, in favor of the defendants, appellees, S. D. Cohn & Company and Sidney D. Cohn, and remanded the cause for further proceedings.

Copies of the following decisions, opinions and judgments are appended hereto:

Appendix A — Order-Decision of Fifth Circuit, Dated October 15, 1975, denying petition for rehearing (A. 1-7). 521 F.2d 225.

Appendix B-1 — Judgments of the United States Court of Appeals for Fifth Circuit, dated July 3, 1975, vacating judgment and order of trial court (A. 8-9).

Appendix C — Opinion of United States Court of Appeals for the Fifth Circuit, dated July 3, 1975 (A. 10-53).

A. Appendix to this Petition.
R. Reference to pages of trial transcript in record below.

Appendix D — Order of United States District Court, Southern District of Florida, denying motion of plaintiffs for relief from judgment (A. 54).

Appendix E — Order of United States District Court In And For Southern District of Florida, dated October 3, 1973, denying motion of plaintiffs for rehearing, and to amend findings of facts and conclusions of law (A. 55).

Appendix F — Final Judgment Of United States District Court In and For Southern District of Florida bearing date September 14, 1973 (A. 56).

Appendix G — Findings of Fact and Conclusions of Law Of United States District Court, Southern District of Florida, dated May 22, 1973 (A. 57-68).

B.

GROUNDS UPON WHICH JURISDICTION OF THIS COURT IS INVOKED

The judgment of the United States Court of Appeals for the Fifth Circuit herein bears date July 3, 1975. The petition for rehearing was denied on October 15, 1975. The original opinion of the Fifth Circuit bears date July 3, 1975 (Appendices A-C). Jurisdiction is invoked pursuant to 28 U.S.C., §1254; and 28 U.S.C., § 2101(c); and Supreme Court of the United States, Revised Rules, Effective July 1, 1970, Rule 19(1)(b); Rule 21; Rule 22(3).

C.

QUESTIONS PRESENTED FOR REVIEW ON MERITS

I. WHETHER COURT OF APPEALS IMPROPERLY SUBSTITUTED ITS JUDGMENT ON THE FACTS FOR THAT OF THE TRIAL COURT.

II. WHETHER COURT OF APPEALS ERRONEOUSLY VACATED JUDGMENT OF TRIAL COURT, AND REMANDED FOR FURTHER PROCEEDINGS, AFTER PLAINTIFFS FAILED IN THEIR PROOF ON CLAIM OF VIOLATION BY DEFENDANTS OF SECURITIES & EXCHANGE ACT OF 1934, §10(b); 15 U.S.C.A. §78j(b) (1970); AND IN ANY EVENT, WHETHER COURT OF APPEALS SET FORTH ERRONEOUS STANDARDS FOR RECOVERY IN 10b-5 CASE.

III. WHETHER COURT OF APPEALS ERRONEOUSLY REJECTED DEFENSE OF "IN PARI DELICTO" AS A MATTER OF LAW, AND APPLIED IMPROPER STANDARDS FOR ITS APPLICABILITY, NOTWITHSTANDING TRIAL COURT'S FACTUAL DETERMINATION THAT DEFENSE WAS ESTABLISHED.

D.

STATUTES AND REGULATIONS INVOLVED

1. Securities and Exchange Act of 1934, §10b; 15 U.S.C. §78j(b) (1970):

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

* * *

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest for the protection of investors.

2. S.E.C. Rule 10b-5; 17 C.F.R. §240.10b-5 (1974):

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

3. Securities Exchange Act of 1933, §4(2); 15 U.S.C.A. §77(d)(2):

The provisions of section 77(e) of this title shall not apply to . . . (2) transactions by an insurer not involving any public offering.

E.

STATEMENT OF THE CASE

1. Proceedings Below

The Plaintiffs (respondents here), SHIRLEY WOOLF and ROBERT MILBERG (hereinafter referred to as WOOLF and MILBERG), brought suit against the Defendants (petitioners here) S. D. COHN & COMPANY and SIDNEY D. COHN (hereinafter referred to as S. D. COHN & COMPANY and COHN), in the United States District Court, in and for the Southern District of Florida, to recover damages for the alleged violation of Rule 10(b)(5), adopted by the Securities And Exchange Commission pursuant to Section 10(b) of the Securities And Exchange Act

of 1934, in the purchase and sale of securities. The Defendants, S. D. COHN & COMPANY and COHN, filed an Answer and Counterclaim for securities fraud and breach of contract. The Defendants subsequently filed a Third Party Complaint against FIBERGLASS RESOURCES CORPORATION, the issuer of the debentures purchased by the Plaintiffs. The Third Party Defendant, FIBERGLASS RESOURCES CORPORATION (hereinafter referred to as FIBERGLASS), responded to the Third Party Complaint with an Answer and affirmative defenses.

The cause came on for non-jury trial before Judge Norman C. Roettger, Jr., on January 8 and 9, 1973. After hearing all the evidence and testimony presented, the Court found in favor of the Defendants, S. D. COHN & COMPANY and COHN, and entered findings of fact and conclusions of law on May 22, 1973. No violations were found, and in any event, if there were violations, the Plaintiffs were in "pari delicto," found the trial court. (A. 57-68). Final Judgment in favor of the Defendants and against the Plaintiffs was accordingly entered on September 14, 1973, by the trial Court (A. 56), and post-trial motions were denied (A. 55).[1]

As we have seen, the Fifth Circuit reversed and remanded for further proceedings and testimony, on possible violations of 10b-5; and rejected the defense of in pari delicto.

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[1]The Final Judgment, in accord with the findings of fact and conclusions of law, also granted judgment for the Counter-Defendants against the Counter-Plaintiffs and ordered that since the Defendants were not liable to the Plaintiffs, the Third Party Complaint was rendered moot. An order denying relief from the judgment of necessity was vacated (A. 8, 54; Appeal 71-2449).

2. The Facts Shown at Trial

The Defendant, COHN, was a general partner in the Defendant firm, S. D. COHN & COMPANY, which was a partnership registered as a broker-dealer in securities, pursuant to the Securities Exchange Act of 1934.

In mid-1968, COHN first became aware of FIBERGLASS RESOURCES CORPORATION through Jonas Medney who informed COHN of the opportunity for the new company to purchase the assets of the Lamtex division of Koppers Company, Inc.

Jonas Medney, the President of FIBERGLASS RESOURCES CORPORATION, started the Lamtex operation in 1955, and then sold the company to Koppers Co., Inc. in 1963, but remained as President of the Lamtex subsidiary of Koppers until 1968. Koppers purchased the Lamtex operation in 1963, for the amount of $1,800,000. However, FIBERGLASS RESOURCES CORPORATION had the opportunity to purchase the assets of the Fiberglass reinforced plastic pipe factory of Lamtex for $650,000. To raise the operating capital required by FIBERGLASS RESOURCES CORPORATION in the purchase of the Lamtex assets, FIBERGLASS authorized the issue of $600,000.00 principal amount of its 6¼% convertible debentures. S. D. COHN & COMPANY, as a registered broker-dealer, was employed by FIBERGLASS RESOURCES CORPORATION to facilitate the private placement of the debentures, and in compensation for such services, S. D. COHN & COMPANY, would receive a commission of 7½% of the principal amount of the debentures sold as per paragraph ten of the Debenture Agreements. (Plaintiffs' Exhibit 11).

Based upon his knowledge of the situation, including his previous exposure to Medney as President of the Lamtex Division of Koppers, the Defendant, COHN, believed that purchase of FIBERGLASS debentures was an attractive investment.[2] (R. 274-275). While purchasing FIBERGLASS debentures on behalf of S. D. COHN & COMPANY (R. 312, Plaintiffs' Exhibit 11), COHN notified the Plaintiff, MILBERG, a business and social acquaintance of COHN, of the opportunity to purchase such debentures. COHN provided MILBERG with the information concerning FIBERGLASS obtained from Medney. (R. 22-24, 268, 306, 336, 386). He told him all he knew about the proposed transaction. (A. 9). MILBERG then conveyed the investment opportunity to the other Plaintiff, WOOLF. (R. 28, 119). Each of the Plaintiffs paid $50,000.00 for 6¼% convertible subordinate debentures of FIBERGLASS RESOURCES CORPORATION. (Plaintiffs' Exhibits 3, 11).

In the composite debenture agreement (PX. 2), signed by the Plaintiffs when they bought the bonds, they represented and warranted that they bought the bonds for investment only, and no other persons had a beneficial interest. MILBERG openly admitted this warranty, upon which FIBERGLASS relied in selling Plaintiffs the debentures, was untrue. (R. 71).

Prior to the purchase by the Plaintiffs in October, 1968, of the FIBERGLASS debentures, both MILBERG and WOOLF had substantial knowledge of the investment market. From 1952 to 1960, MILBERG was employed by Bache & Co., members of the New York Stock Exchange, as a salesman, account executive, and resident manager of

[2]COHN did advise the investors that the situation was highly speculative (R. 298-299, 337-338).

the Miami office. Following his affiliation with Bache & Co., MILBERG became a salesman for International Equities, an over-the-counter firm. In the mid-1960's, MILBERG was employed by Herzfeld, Stern and Hentz & Company as a customer's man. From March, 1969, to December, 1970, MILBERG was employed by the Defendant, S. D. COHN & COMPANY, as manager of the Miami office.

Prior to her purchase of FIBERGLASS debentures, WOOLF had made substantial investments in the stock market through S. D. COHN & COMPANY in the $100,000 to $200,000 range. WOOLF had known MILBERG for a considerable length of time, and MILBERG would chart stocks for Miss WOOLF and her investment partner, Harold Vineberg, in return for fifteen percent of the profits made on the stocks charted. (R. 199, 228, 238, 259). WOOLF, with Vineberg, traded heavily in many brokerage houses, not only S. D. COHN & COMPANY. Miss WOOLF has been a practicing lawyer in Florida for some 28 years since graduation from St. John Law School in Brooklyn, New York, and is a current member of the New York and Florida Bars. A significant portion of her practice entails commercial law, and among her clients was a New York finance company. (R. 165).

In August, 1968, a summary (Plaintiffs' Exhibit 1) was prepared by FIBERGLASS RESOURCES CORPORATION. The summary was furnished to COHN, however, COHN *did not* provide the summary to WOOLF and MILBERG since the summary was not intended for further distribution. (R. 294, 302, 389-390, 396, 415). At the time the summary was made, the projections and forecasts of the future prospects of FIBERGLASS RESOURCES

CORPORATION had a reasonable basis in fact and in method of preparation, and, if anything, the forecasts tended to be on the low side. In the summary, it was stated that "the remainder of 1968, is not shown except that a gross profit of $225,000.00 and net after taxes of $100,000.00 is shown due to the Pakistan job which is the condition of the purchase of the plant". (Plaintiffs' Exhibit 1). FIBERGLASS RESOURCES did in fact receive the Pakistan contract, supported by a letter of credit, thus opening the door for the purchase of the Lamtex plant. (R. 388-389).

Subsequent to the procurement of the Pakistan contract, FIBERGLASS RESOURCES was unexpectedly faced with revolution in Pakistan and an extensive dock strike. (Plaintiffs' Exhibit 17, R. 89, 272, 401). As a result thereof, additional financing was required in 1969 by FIBERGLASS. (R. 401-404). In order to obtain additional financing, it was necessary for FIBERGLASS to convert the debentures into common stock. (R. 402-403). Accordingly, the holders of FIBERGLASS debentures, including WOOLF and MILBERG, were requested by FIBERGLASS to convert their debentures into common stock. (R. 403). The Plaintiffs, WOOLF and MILBERG, did convert their debentures into 16,666 shares each of FIBERGLASS RESOURCES CORPORATION stock, plus each Plaintiff received a check from FIBERGLASS in the amount of $1,224.31 as interest on the debentures. (Plaintiffs' Exhibits 4, 12, 13, 14, 15).

At the time of the conversion of the debentures by the Plaintiffs, MILBERG visited the fiberglass plant in March of 1969, and was given a tour of the plant by Jonas Medney. In addition to the plant visit, MILBERG had a sub-

stantial number of telephone conversations with Medney, at which times MILBERG had complete access to all information regarding the financial condition of FIBERGLASS RESOURCES CORPORATION. (R. 87-88, 384-386). Additionally, WOOLF received financial statements of FIBERGLASS RESOURCES CORPORATION. (T. 224-225, 426, 428).

By letter of August 4, 1971 (Defendants' Exhibit 1), the Plaintiffs, WOOLF and MILBERG, represented to Jonas Medney of FIBERGLASS that although 16,666 shares of FIBERGLASS stock had been registered in each of their names, WOOLF and MILBERG were "in actuality, the nominees since the date of purchase for 22 Florida residents". The letter further represented that the various investors "evidenced great discontent" and "intended to communicate with the Chemical Bank directly". (Defendants' Exhibit 1). At trial, the Plaintiffs openly admitted that the representations were false when written. (R. 47, 49-53, 61, 161, 173-174). WOOLF and MILBERG manufactured the falsehood regarding twenty-two Florida purchasers to cause Medney to believe that the private placement of the debentures was to more than twenty-five people and thus raised the possibility of violation of the securities law regarding registration. (R. 161). Adding the alleged twenty-two Florida purchasers to the other few FIBERGLASS investors would come to more than twenty-five purchasers.

At the time the letter was written, FIBERGLASS was negotiating a loan through the Chemical Bank, and any possible violation of securities laws by FIBERGLASS could "blow the deal", using the language of the Plaintiffs. (R. 380-381). In direct reliance upon the misrepresentations of WOOLF and MILBERG contained in the August 4, 1971 letter to FIBERGLASS and without ever being informed that the misrepresentations were just that, FIBERGLASS purchased the 33,332 shares of FIBERGLASS stock registered in the Plaintiffs' names for $35,000 on August 26, 1971. (R. 144, 382-384, Defendants' Exhibit 3). Upon repurchase of the 33,332 shares of WOOLF and MILBERG by FIBERGLASS, WOOLF and MILBERG executed a release which stated that "sellers (Plaintiffs) have received full financial data concerning the Company from the inception of the Company until and including the year ended June 30, 1971". (Defendants' Exhibit 3).

The actual number of participants in the purchase for $100,000 of FIBERGLASS debentures in the Plaintiffs' names was neither twenty-two nor two, but instead seven. (R. 40, 141). Despite the existence of seven investors in the purchase of FIBERGLASS debentures in the Plaintiffs' names, WOOLF and MILBERG represented and warranted to FIBERGLASS at purchase of the debentures that they were acquiring the debentures for their own account for investment only and not with a view to distribution, and "no other person has any beneficial interest in, or right to acquire, the debentures". (Plaintiffs' Exhibit 11, Paragraph 3 of additional terms of debenture agreement, Defendants' Exhibit 2, Paragraph 3 of additional terms of debenture agreement).

3. The Findings of the Trial Court

The facts are clearly set forth in the findings of the trial court. (A. 57-68). It is unnecessary to delve into them further here, except to state that the Defendants' testi-

mony and evidence were accepted, and the conflicting evidence of the Plaintiffs was rejected. The trial court concluded as follows:

> "The evidence produced at trial clearly and convincingly showed that the plaintiffs did not establish any misrepresentations or omissions of material fact knowingly committed by the defendants and relied upon by the plaintiffs in the relevant securities transactions, and the defendants are not guilty of violating §10(b) of the Securities Exchange Act of 1934, or Rule 10b-5 issued thereunder and are not liable to the plaintiffs."

The trial court also clearly held that:

> "Regardless of the defendants' guilt or innocence, under Rule 10b-5, the plaintiffs would be precluded from recovery as a result of their own violations of §10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 issued thereunder in their transactions with Fiberglass Resources Corporation. The defense of *in pari delicto* is applicable to the factual situation before this Court. . ." (A. 67).

The trial court also found that the Plaintiffs were sophisticated investors who had not shown the necessary degree of reliance in this case to entitle them to recovery; and found that the third-party claim was moot because the Defendants were not liable to the Plaintiffs. The court did not reach the defense of lack of indispensable parties, which had been raised by the Defendants. The Defendants, as counter-claimants, introduced no evidence of damages; therefore their counterclaim was rejected. (A. 67-68).

4. The Opinion of the Fifth Circuit

The United States Court of Appeals for the Fifth Circuit reversed and remanded for further proceedings. The opinion is extensive. It recites facts and acknowledges the conflicts in the evidence. (A. 11-22). Nevertheless, the opinion appears to reevaluate the facts and testimony—without even suggesting that the trial court's findings were "clearly erroneous". (See, e.g., A. 11-22). All of the material conflicts, however, were resolved in favor of the Defendants by the trial court.

Nevertheless, the Fifth Circuit reversed and found that the "in pari delicto" defense was not available to the Defendants here, as a matter of law, because the misconduct of the Plaintiffs was not "mutual, simultaneous, and relatively equal", to the Defendants' alleged misconduct and securities law violations; and held that the Plaintiffs could be barred, only if they were active, essential and knowing participants in the unlawful activity. (A. 29). The Fifth Circuit held that the conduct of the Plaintiffs, while not to be condoned, did not bar the Plaintiffs from recovery here; and such a bar, for the type of misconduct in which they concededly indulged, would be inimical to the purposes of the securities laws.

Similarly, the Fifth Circuit acknowledged that it was determining a novel question on the issue of whether or not a Rule 10b-5 violation could be shown here, and stated as follows:

> "The difficult question this case presents—and, so far as our research shows, it is a novel one—is the extent to which rule 10b-5 provides a rem-

edy to a purchaser of securities against the issuer or others involved in the distribution when the issuer and its agents fail to conduct the distribution in such a manner that it qualifies for the exemption from registration provided by §4(2) of the Securities Act of 1933, 15 U.S.C., §77(d)(2) (1970)." (A. 33).

The Fifth Circuit held that there was such a remedy, and the Defendants could be liable here, for non-disclosure (without affirmative proof of reliance) under 10b-5; for failure to conduct the sale in such a way as to obtain the benefit of the exemption for private placements, provided the non-disclosures were sufficiently important. The Fifth Circuit also held that in a private offering, the issuers and their agents were obliged to furnish information beyond that which would be required in registration. The cause was reversed to afford the Plaintiffs a further opportunity to prove their case because of alleged record inadequacies on the nature of the offering and information conveyed. Thus, the Fifth Circuit held as follows:

"On the present record, we cannot say whether the transaction here qualified as a private offering under §4(2) of the 1933 Act. We have indicated some of the inadequacies in the record, and, on remand, the burden is on the defendants to establish the availability of the exemption. The unusual aspect of this case, however, is that even if the defendants should fail to demonstrate the availability of the exemption, the plaintiffs may fail to recover the balance of the purchase price. For the plaintiffs did not bring suit under §12 of the 1933 Act but rather under §10b of the 1934

Act and Rule 10b-5. It follows that they must show that the omissions or misrepresentations of information that make §4(2) exemption unavailable to the defendants, in their cumulative effect, was such that a reasonable investor, at the information registration would have afforded been available, might have considered them important in the making of his investment decision." (A. 52).

The Fifth Circuit adhered to its decision and opinion, in a further opinion on rehearing. (A. 1-7). This petition followed.

F.

REASONS FOR GRANTING THE WRIT

I. CIRCUIT COURT OF APPEALS ERRONEOUSLY SUBSTITUTED ITS JUDGMENT ON FACTS FOR THAT OF THE TRIAL COURT

The trial court entered extensive findings of fact and conclusions of law. They reflect clear and convincing evidence that no material misrepresentations and no material non-disclosures were made and relied upon by these sophisticated investors. There were no 10b-5 violations. The trial court made specific findings after an extensive summary of the evidence (A. 57-68). Those findings were not "clearly erroneous" or found to be clearly erroneous. Accordingly, the Fifth Circuit should not have reversed; *U.S. v. U.S. Gypsum Co.*, 333 U.S.364, 68 S.Ct.525; Rule 52(a), Federal Rules of Civil Procedure. The findings on both absence of violations of 10b-5 by the defendants; and on the defense

of "in pari delicto" thus should have been permitted to stand. There is no basis for reversal, on the clear-cut findings here; and such a reversal of course was precluded by Rule 52(a), and the U.S. GYPSUM Co. case. Most respectfully, the writ should be granted because of this apparent violation of cardinal principle of appellate review in the Federal Court system.

II. COURT OF APPEALS ERRONEOUSLY VACATED JUDGMENT AND ORDER OF TRIAL COURT, AND REMANDED FOR FURTHER PROCEEDINGS, AFTER THE PLAINTIFFS FAILED IN THEIR PROOF ON CLAIMS OF VIOLATION BY DEFENDANTS OF SECURITIES AND EXCHANGE ACT OF 1934, §10b, 15 U.S.C.A. §78j(b); AND RULE 10b-5, 17 C.F.R.240.10b-5 (1974); AND IN ANY EVENT, COURT OF APPEALS SET FORTH ERRONEOUS STANDARDS FOR RECOVERY IN 10b-5 CASE.

The plaintiffs failed in their proof. There was no basis here whatsoever for a reversal, and remand for further proceedings. Either the plaintiffs proved their case or they didn't — and the Fifth Circuit has at least implicity held that they did not. We find nothing in the law which permits remand for further proceedings to the end that the plaintiffs may have another bite at the apple. They did not prove any 10b-5 violations, and there the matter must rest. The "inadequacies" of the record are not the problem of the defendants-petitioners. Nor do we agree with the resolution by the United States Court of Appeals for the Fifth Circuit of what it has deemed a novel question.

The Fifth Circuit has held that a 10b-5 violation may arise when an issuer fails to conduct a distribution in such a manner as to qualify for the private placement exemption from registration provided by §4(2) of the Securities Act of 1933. As a matter of fact, suit here was not even brought here under §12 of the 1933 Act (15 U.S.C.§77(l)) (1970); for failure to comply with registration requirements. Clearly, the placement here was a private one, which cannot be seriously contested here, even under the Fifth Circuit view set forth in *Hill York Corp. v. American Int. Franchises*, 5 Cir. 1971, 448 F.2d 680; despite the opinion below. The gravaman of the action was for fraud or misrepresentation or material non-disclosures. None were shown. A public offering or non-exempt offering with non-registration was not claimed. No 10b-5 violation can nor does exist here.

The Fifth Circuit found that a 10b-5 violation could arise out of alleged violations of the 1933 Act in the area of private offerings. The Fifth Circuit in its opinion, (A. 37), then held that in the area of a private placement, the duty to provide information by the issuer was to furnish *more than* the information which registration would have revealed (A. 43-52). It relied upon its own decision in *S.E.C. v. Continental Tobacco Co.*, 5 Cir. 1972, 463 F.2d 137. In the first place, nothing else in the law or securities legislation required, as the Fifth Circuit seemed to do, that an issuer of a private placement was to be charged with the duty of conveying information beyond what registration in the case of public placement would reveal. The Fifth Circuit alone appears to have imposed this duty.

In the second place, the record here reveals that indeed the plaintiffs failed to prove any violation anyhow, or any

failure to impart any information material or otherwise (A. 38). They have not shown failure of the defendants to convey any material information. To the contrary, Mr. Cohn had imparted to Mr. Milberg "all the information on Fiberglass" that Cohn believed to be true and accurate (A. 38). The onerous burden sought to be imposed here is beyond anything reflected in the law of securities in other circuits.

The court below has held that failure to convey information, beyond that even required in registration, rules out the exemption of §4(2). But a remedy for registration violations or violations in connection with non-exempt offerings, is provided (15 U.S.C. §77(l)). No suit was brought under those provisions. The Fifth Circuit, *in a 10b-5 case*, nevertheless seems to impose upon the defendants the obligation of proving they fall within the exemption and that they have conveyed the Fifth Circuit formulation of sufficient information in a 10b-5 fraud case. While the burden of proof might be on the issuer in other areas of the law, where there is a regulatory suit, or other suit brought under 15 U.S.C. §77(e) or (l); and the §4(2) exemption is claimed, *S.E.C. v. Ralston Purina Co.*, 346 U.S. 119, 126 73 S.Ct.981, 985, the plaintiff, in a 10b-5 case, has the burden of proof and simply has not met it here. *Hecht v. Harris Upham & Co.*, 9 Cir. 1970, 430 F.2d 1202, 1209; *Mader v. Armel*, 6 Cir. 1968, 402 F.2d 158, 163, cert. den., 1969, 88 S.Ct. 1188. The defendants were not sued for the unlawful sale of unregistered securities (15 U.S.C. §77e, 77(1) (1970). They were sued for unlawful trick or device or for fraud or misrepresentation or non-disclosure. They failed to prove fraud, or non-disclosure and damages. And while reliance in a 10b-5 case may be presumed in a case of material non-disclosure,

under certain circumstances, *Affiliated UTE Citizens of the State of Utah v. U.S.*, 406 U.S. 128, 92 S.Ct. 1456, here reliance was — in essence — negated. (A. 40). There was no basis for reversal. We fail to see how a new trial now can be afforded to the plaintiffs, who failed in their proofs — to the end that they might have further opportunity to prove what they failed to prove in the first instance. Moreover, by their own trick, artifice and device, the Plaintiffs resold the debentures, when they could have avoided loss by holding them; and signed a release; and a "rescission" remedy is impossible.

III. THE COURT OF APPEALS ERRONEOUSLY REJECTED DEFENSE OF "IN PARI DELICTO" AS A MATTER OF LAW, AND APPLIED IMPROPER STANDARDS FOR ITS APPLICABILITY, NOTWITHSTANDING TRIAL COURT'S FACTUAL DETERMINATION THAT DEFENSE WAS ESTABLISHED.

In *Kuehnert v. Texstar Corporation*, 412 F.2d 700 (5 Cir. 1969) the Fifth Circuit itself stated that the equitable doctrines of *in pari delicto* and unclean hands are defenses available in private 10b-5 litigation, although the application of such defenses rests in the sound discretion of the *trial court. See also, Clement A. Evans & Co. v. McAlpine*, 434 F.2d 100, 104 (5 Cir. 1970).

The applicability of the defenses of *in pari delicto* and unclean hands to the case at bar is in no way limited or discounted by the case of *Katz v. Amos Treat & Co.*, 411 F.2d 1046 (2d Cir. 1969), cited below. In refusing to foreclose the plaintiff from seeking relief under section 12 (1) of the 1933 Securities Act due to the plaintiff's

own violation of the securities provision, the Second Circuit in *Katz* held "the case is not one where [the plaintiff] so made himself a part of the basic violation that recovery should be denied on the basis of *in pari delicto*". *Id.* at 1054. As supporting authority, the *Katz* opinion refers to *Can-Am Petroleum Co. v. Beck*, 331 F.2d 371, 373-374 (10 Cir. 1964), wherein the plaintiff "at no time had the degree of culpability attributed to the defendants and should not be considered as *in pari delicto*." In fact, the Court in *Kuehnert* emphasized that the case before it was "not a case of mere knowledge of another party's wrongdoing, without active participation", and reference was made to *Can-Am Petroleum Co.* as just such a case of passive participation. *Kuehnert* at 703.

Furthermore, the Second Circuit in *Katz mentions the contrasting* case of *Athas v. Day*, 186 F.Supp. 385 (D. Colo. 1960). The contrasting aspect of the *Athas* case is the active participation of the plaintiff in the alleged fraudulent sale of stock; thus, the plaintiff was barred from recovery against the defendant.

In the present case the culpability of the Plaintiffs in violating Rule 10b-5 was equal to, if not greater than, any alleged wrongdoing on the part of the Defendants. One major difference is the uncontradicted nature of the Plaintiffs' admitted securities fraud perpetrated upon the third-party defendant, FIBERGLASS. In its conclusions of Law, the trial Court clearly distinguished the *Katz* case from this case.

> Plaintiffs rely heavily upon *Katz v. Amos Treat & Co.*, 411 F.2d 1046 (2 Cir. 1969) and claim it cannot be distinguished from the instant case.

> Quite to the contrary, there is nothing in the evidence in the instant case to show Defendant's conduct came within a fraction of the outrageous activities of the Defendant-broker in *Katz*, such as staging "a dog and pony show" at the plant of the corporation in question to assure prospective purchasers of the thriving nature of the corporation's business. In addition, Katz was duped and tricked at one stage after another and understandably the Second Circuit held he was not in *pari delicto* with the defendants. On the other hand, in the instant case Plaintiffs' letter of August 4th, 1971 was an admittedly false bluff which caused FIBERGLASS to purchase Plaintiffs' shares of stock. (A. 67).

By letter of August 4, 1971, WOOLF and MILBERG provided formal notice to FIBERGLASS through its president, Jones Medney, that although 16,666 shares of Fiberglass stock are registered in each of the plaintiffs' names, the plaintiffs are actually the nominees for 22 Florida residents. (Defendants' Exhibit 1). Such a statement was admitted to be false by both plaintiffs. The reason for making such a false statement was to get action from FIBERGLASS, since the Plaintiffs and Medney were well aware that if in fact there were twenty-two Florida purchasers rather than just the two Plaintiffs, then the otherwise private offering by the issuer, FIBERGLASS, might be considered to be public (more than 25 purchasers) and raise the spector of a violation by FIBERGLASS of the registration provisions of the securities laws on the grounds of a public offering of unregistered stock. (R. 161). To further gain the attention of FIBERGLASS, the Plaintiff made the additional material misrep-

resentation in the August 4, 1971 letter that other co-investors intended to communicate with the Chemical Bank, with whom FIBERGLASS was attempting to obtain a loan from. Medney testified that notice to the Chemical Bank of a possible securities violation by FIBERGLASS would jeopardize the loan. (R. 379). In reliance solely on the misrepresentations communicated to it by the plaintiffs, FIBERGLASS purchased on August 16, 1971 the 33,332 shares of stock held by the Plaintiffs for the sum of $35,000. (R. 379-384).

According to Medney, FIBERGLASS would not have purchased the Plaintiffs' stock had it known there were not *twenty-two purchasers* as per the August 4, 1971 letter and that investors were not going to the Chemical Bank. (R. 383-384). FIBERGLASS could ill-afford to be faced with a registration violation as alluded to in the August 4, 1971 letter at the time it was seeking a vital loan from the Chemical Bank. The aforedescribed fraudulent acts of the Plaintiffs constituted a clear-cut violation of Rule 10b-5. All the necessary elements of a 10b-5 violation were present. The statements of the Plaintiffs as to the twenty-two purchasers and informing the Chemical Bank were material misrepresentations of fact and the Plaintiffs knew the statements were totally false when made. FIBERGLASS, by relying on such false and fraudulent statements, was proximately damaged to the extent of $35,000. The plaintiffs utilized the interstate mails to employ a scheme to defraud FIBERGLASS. Therefore, even if the Defendants were found to have violated Rule 10b-5 by defrauding the Plaintiffs, which cannot be the case, the Plaintiffs nevertheless would be unable to recover from the Defendants as a result of their own violation of Rule 10b-5, which places them *in pari delicto* with the

Defendants. The Plaintiffs' hands are not so clean as to entitle them to relief against the Defendants whose hands were not even soiled.

The hands of the Plaintiffs were further dirtied by other acts done by them relating to the transaction in issue. In the composite Debenture Agreement (Plaintiffs' Exhibit 11, Defendants' Exhibit 2), representing the Plaintiffs' purchase of debentures of FIBERGLASS and which was executed by the Plaintiffs, the Plaintiffs represented and warranted that they purchased the debentures for investment only and no other person, besides MILBERG and WOOLF, had any beneficial interest in the debentures. MILBERG admitted that the representation was untrue since there were other beneficial interests in the debentures purported to be purchased by the Plaintiffs. (R. 71). Again, the plaintiffs violated Rule 10b-5 by making a misrepresentation of material fact in the purchase of securities, and FIBERGLASS relied on such misrepresentation by agreeing to sell debentures to the Plaintiffs in the belief that the Plaintiffs were not purchasing the debentures on behalf of other investors. This misrepresentation inhered right in the original purchase.

The Plaintiffs committed fraud both in the purchase and sale of the FIBERGLASS securities. The unconscionable conduct of the Plaintiffs throughout the course of the transaction in issue bars them from any recovery against the Defendants, if recovery were appropriate which it properly was not.

The application or rejection of the clean hands doctrine in a given case is equitable in nature and within the discretion of the trial court. *Kuehnert v. Texstar*

Corporation, 412 F.2d 700, 704 (5 Cir. 1969). The trial Court, upon consideration of the totality of the circumstances, properly exercised its discretion in applying the doctrines to preclude the Plaintiffs from recovery.

Though the Plaintiffs argued and the Fifth Circuit found, that the equitable defenses are inapplicable since the Plaintiffs' fraud was *unrelated* to the subject matter in litigation, the reality is that the Plaintiffs' misconduct is part and parcel of the transactions in issue. The doctrine of unclean hands is applicable "to misconduct in relation to or in all events connected with the matter in litigation so that it in some manner affects the equitable relations of the parties to the suit." *McCullough Tool Company v. Well Surveys, Inc.*, 395 F.2d 230, 238 (10 Cir. 1968).

Unquestionably, the fraudulent conduct of the Plaintiffs is intimately connected with the suit brought by the Plaintiffs for alleged securities fraud committed by the Defendants in the sale of the FIBERGLASS debentures to the Plaintiffs for $100,000 with the alleged loss resulting from their re-purchase by FIBERGLASS for $35,000. In the purchase of the debentures by the Plaintiffs, the Defendants participated as brokers for FIBERGLASS. If the Defendants can be sued for fraud in the purchase of the debentures by the Plaintiffs from the issuer, FIBERGLASS, it is only fair that the Plaintiffs be allowed to assert that the hands of the Plaintiffs were unclean in the purchase of the debentures from FIBERGLASS.[3]

[3]Additionally, at the time of the purchase of the debentures, S. D. COHN & CO. possessed 100,000 shares of FIBERGLASS stock and COHN was an officer and director of FIBERGLASS. (Plaintiffs' Exhibit 11, Defendants' Exhibit 2).

Likewise, the fraud perpetrated by the Plaintiffs in obtaining the purchase of their interests by FIBERGLASS for $35,000 is a necessarily-connected transaction in the chain of purchase and sale of the securities in issue and is directly related to the events pertaining to the matter in litigation.

Despite the contention of the Plaintiffs that the fraud in the re-purchase of the securities did not affect the Defendants, the interests of the Defendants were directly affected by the re-purchase. As a substantial stockholder in FIBERGLASS, S. D. COHN & CO. had a vested interest in all transactions conducted by FIBERGLASS, especially a pay-out of $35,000 to re-purchase FIBERGLASS stock. Since each shareholder owns a part of the corporation, a fraud perpetrated upon the corporation of necessity is a fraud upon the shareholders. There should have been no reversal.

G.

CONCLUSION

The petition for a writ of certiorari should be granted and the decision and judgments of the United States Court of Appeals For the Fifth Circuit should be quashed and reversed, with directions to reinstate the judgment and order of the trial court. Certainly, most respectfully, this Court should review this matter. The Fifth Circuit itself has determined that it has passed upon a novel question of federal securities law. Accordingly, under Rule 19b of the Rules of this Court, certiorari review is indicated because the Court of Appeals "has decided an important question of federal law which has not been, but should be, settled by this Court". Moreover, departures from the clearly erroneous rule are indicated here, further warranting review of this Court in an important area of federal law.*

Respectfully submitted,

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BY_____
ROBERT ORSECK

*In a separate appeal, the plaintiffs in the trial court sought relief from the final judgment (No. 74-2449), under Rule 60b, claiming that the judgment was obtained by false testimony. That appeal was consolidated with the main appeal (No. 73-4011). The Fifth Circuit found it unnecessary, apparently, to resolve the issues on the 60(b) appeal. Needless to say, the trial court had denied that application (A. 8, 54).

H.

CERTIFICATE OF SERVICE

WE HEREBY CERTIFY that three true copies of the foregoing Petition for a Writ of Certiorari and Appendix has been mailed this ____day of January, 1976 to: Richard E. Reckson, 3501 Biscayne Boulevard, Miami, Florida; and to Terrence Russell, 900 N.E. 26 Street, Ft. Lauderdale, Florida, Attorneys for Respondents, in accordance with Rule 33 of this Court.

BY_____
ROBERT ORSECK